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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 257

WILLIAM T. SPENCE, *Petitioner*,

v.

BALOGH & COMPANY, INC., *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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The petition of William T. Spence for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit from a judgment entered on the 25th day of April, 1963, affirming a judgment against your petitioner and in favor of the respondent, entered in the United States District Court for the District of Columbia on the 31st day of July, 1962, respectfully shows:

The opinion of the United States Court of Appeals for the District of Columbia Circuit has not been

officially reported at the time this is written, but a copy of the opinion is appended to this petition.

The judgment of the United States Court of Appeals for the District of Columbia Circuit is dated April 25, 1963.

BASIS OF THE COURT'S JURISDICTION

The jurisdiction of this Court is based on Title 28, U. S. C. A., § 1254 (1).

The decision of the United States Court of Appeals for the District of Columbia Circuit is in direct conflict with the "Securities Act of 1933", May 27, 1933, C. 38, Title 1, § 1, 48 Stat. 74, Title 15 U. S.C.A., § 77 a, et seq., creating the Securities and Exchange Commission, and its regulations formulated and approved by the Commission under the authority vested in it by the Act of Congress.

The judgment of the United States Court of Appeals for the District of Columbia Circuit is in conflict with its own decisions in *U. S. Shipping Board Emergency Fleet Corporation* v. *Levensaler, et al.*, 53 App. D. C. 322, 290 F. 297, and *No Leak O. Piston Ring* v. *Chandlee*, 53 App. D. C. 128, 299 Fed. Rep. 526.

The judgment of the United States Court of Appeals for the District of Columbia Circuit is in conflict with the decisions of other Circuit Courts of Appeals in *Cudahy Packing Company* v. *Narzisenfeld*, 3 F. (2d) 567, *Cobin* v. *Midland Mutual Life Insurance Company*, 260 F. (2d) 92, and *Dale* v. *Rosenfeld*, 229 F. (2d) 855.

QUESTIONS PRESENTED

1. Was the United States Court of Appeals for the District of Columbia Circuit in error in affirming the judgment of the United States District Court for the District of Columbia which held that a registered securities' dealer and a member of the National Association of Securities' Dealers was an agent of the issuer and not a principal in the sale of stock to petitioner, where the written confirmation of the sale, which, by the Regulations of the S. E. C., was required to be sent to every customer, contained the following statement:

> "As principal and for our account we confirm sale to you of 6220 shares of the stock of Northern Virginia Doctors Hospital Corporation." (Plaintiff's exhibit No. 1, J. A. 169).

2. Was the United States Court of Appeals for the District of Columbia Circuit in error in affirming the judgment of the United States District Court for the District of Columbia which permitted the respondent to introduce evidence of the custom of Securities dealers in the District of Columbia to prove that respondent was an agent and not a principal which was contrary to the specific requirements of the Regulations of the S. E. C.?

3. Was the United States Court of Appeals for the District of Columbia Circuit in error in affirming the judgment of the United States District Court for the District of Columbia which permitted the respondent to introduce evidence that he was an agent and not a principal where the clear and unambiguous statement in the confirmation of the sale to petition and which was required by the Regulations of the S. E. C., pur-

suant to the Act of Congress, stated that he was a principal?

S. E. C. REGULATIONS INVOLVED

The term "underwriter" is defined in the Securities Act of 1933, in Title 15-77(b) of the United States Code Annotated, as follows:

> "(11) The term 'underwriter' means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term 'issuer' shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under director indirect common control with the issuer.

Title 15-77b (12) defines a dealer as follows:

> "The term 'dealer means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal; in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person. May 27, 1933, c. 38, Title I, § 2, 48 Stat. 74; June 6, 1934, c. 404, §§ 201, 210, 48 Stat. 905, 908."

Title 17, Code of Federal Practice, Section 240.15. C1-4, contains the requirements of the confirmation of a sale of securities as follows:

"Confirmation of transactions. The term 'manipulative, deceptive, or other fraudulent device or contrivance,' as used in section 15 (c) (1) of the act is hereby defined to include any act of any broker or dealer designed to effect with or for the account of a customer any transaction in, or to induce the purchase or sale by such customer of, any security (other than United States Tax Savings Notes, United States Defense Savings Stamps, or United States Defense Savings Bonds, Series E, F and G) unless such broker or dealer, at or before the completion of each such transaction, gives or sends to such customer written notification disclosing (a) whether he is acting as a broker for such customer, as a dealer for his own account, as a broker for some other person, or as a broker for both such customer and some other person; and (b) * * *"

The requirement of "Disclosure of Control" is set forth in Title 17 of the Code of Federal Practice, Section 240.15c1-5, as follows:

"§ 240.15c1-5—Disclosure of Control. The term 'manipulative, deceptive, or other fraudulent device or contrivance', as used in section 15(c)(1) of the act, is hereby defined to include any act of any broker or dealer controlled by, controlling, or under common control with, the issuer of any security, designed to effect with or for the account of a customer any transaction in, or to induce the purchase or sale by such customer of, such security unless such broker or dealer, before entering into any contract with or for such customer for the purchase or sale of such security, discloses to such customer the existence of such control, and unless such disclosure, if not made in writing, is supplemented by the giving or sending of written disclosure at or before the completion of the transaction. (sec. 2, 52 Stat. 1075; 15 U. S. C. 78o (c)(1))"

STATEMENT OF CASE

On August 3, 1959, the respondent, Balogh & Company, a registered securities' dealer and a member of the National Association of Securities' Dealers, was the distributor, under a public offering, of stock of the Northern Virginia Doctors Hospital Corporation.

The respondent sold, and the petitioner purchased, 6220 shares of this stock at the registered price of $10.00 a share. The respondent confirmed the sale to petitioner on August 4, 1959. A confirmation was a form type paper used by stockbrokers which contained numbered symbols covering the various types of sales made by the broker. The type and symbol used in the instant case was "as principal and for our account we confirm sale to you" of 6220 shares of the stock of the Northern Virginia Doctors Hospital Corporation, and which confirmation required payment in full from petitioner by August 10, 1959 (J. A. 5).

On August 6, 1959, the $62,200.00 was presented to respondent. The respondent then sent written instructions to Riggs National Bank of Washington, the transfer agent for the Northern Virginia Doctors Hospital Corporation, directing the delivery of the stock.

The transfer agent advised respondent that it had closed the transfer books in accordance with instructions from its principal and that it was unable to deliver the stock.

Petitioner, and others, filed an action against the Northern Virginia Doctors Hospital Corporation praying that it be required to deliver the stock. The Northern Virginia Doctors Hospital Corporation, among other things, pleaded that it had withdrawn

this stock from sale long before it was sold to petitioner by an agreement with respondent, and that the respondent had no stock to sell to petitioner.

Petitioner then filed this action against the respondent for an order requiring it to deliver the 6220 shares of stock to petitioner in accordance with its confirmation or to respond in damages for its value and the expenses incurred by petitioner.

The trial judge permitted testimony of alleged expert witnesses covering the custom of securities' dealers in the District of Columbia, which was in direct conflict with the requirements of the Regulation, and the trial judge, in his memorandum opinion, commencing on page 225 of the joint appendix, states:

> "Expert witnesses testified that it was the practice in the investment business in the District of Columbia to so confirm sales when the broker was acting as a 'best efforts' underwriter in the sale of securities for an issuer. As has been noted, both the underwriting agreement and the amendment thereto specifically provided that defendant would only be required to use its 'best efforts' to sell Hospital's securities and that it did not warrant, underwrite, guarantee, or in any way promise or covenant to sell or purchase any of the securities of issuer. A 'best efforts' underwriting makes the investment dealer an agent for the issuer and not a principal." *Securities & Exchange Com'n* v. *Investment Bankers*, 181 F. Supp. 346, 348, n. 4 (D., D.C., 1960)."

The petitioner objected to the testimony of the witnesses and moved to strike the testimony on the ground that it was the Regulations of the S. E. C. and not the practice which governed the decision in this case. The Court denied this motion. The testimony

was also objected to on the ground that the statement contained in the confirmation was plain and unambiguous and that testimony should not have been permitted to overcome the plain intent set forth in that confirmation.

The District Court also, in its memorandum at page 226, stated that petitioner was familiar with both the underwriting agreement and the amendment thereto, for at the time it was entered into he was an officer and director of the hospital. At the time of the sale of stock, petitioner had no connection with the issuer except as a stockholder.

The petitioner testified, on cross-examination, that the hospital did not at any time consider respondent as being an agent. It was also stated by the petitioner that while he referred to the respondent as agent that they were the sole agent for the selling of the stock and that he considered the respondent an underwriter (J. A. 132).

The United States Court of Appeals for the District of Columbia Circuit adopted the memorandum of the trial judge, commencing on page 224 of the joint appendix, and affirmed the judgment.

ARGUMENT

The United States Court of Appeals for the District of Columbia Circuit, by Its Decision, Fails to Give Effect to the "SECURITIES ACT OF 1933" and the Regulations Made Pursuant to This Act

The respondent is a registered securities' dealer and a member of the National Association of Securities' Dealers under Section 78o, Title 15 U.S.C.A. It became the distributor of the stock of the Northern Virginia Doctors Hospital Corporation under an under-

writing agreement filed with the S. E. C. As such distributor or dealer the respondent, in the sale of securities, was required to comply with the pertinent regulations of the S. E. C. Congress, in the "Securities Act of 1933", in § 77 sss, Title 15, U. S. C. A., gave to the Securities and Exchange Commission the power to make necessary regulations.

The regulation of the S. E. C. as to the requirements of the contents of the confirmation is most clear and definite, and it requires that a broker or dealer specifically disclose to the buyer in what capacity it is acting in the sale.

It is admitted that the confirmation was sent out by the respondent and contained the matter it desired to be included therein.

The respondent, in effect, says that it knows that the regulation requires the seller to set forth in the confirmation the capacity in which it is acting, but because it appears to be the practice of other brokers in the District of Columbia to ignore this regulation it had a right to ignore it and when it stated that it was acting as principal it was really acting as an agent.

The Trial Court, in its memorandum (J. A. 225), stated that expert witnesses testified that it was the practice in the investment business in the District of Columbia to so confirm sales when the broker was acting as a "best efforts" underwriter in the sale of securities for an issuer.

The trial Court further, in its memorandum, adopted by the United States Court of Appeals for the District of Columbia Circuit as its opinion, apparently finds a distinction between a firm commitment underwriting and a "best efforts" underwriting, even though the

definition of an underwriter, as contained in the Securities Act of 1933, contains no such distinction.

This section was discussed in the case of *Dale* v. *Rosenfeld*, 229 F. (2d) 855, where it is stated that the term "underwriter" as defined in this section includes "best efforts underwriting" as well as "firm commitment". The trial Court found, as a matter of law, that a "best efforts" underwriting makes the dealer an agent for the issuer and not a principal, citing *S. E. C.* v. *Investment Bankers*, 181 Fed. Supp. 346-348. A reading of the facts in that case clearly discloses that that case comes within the exception contained in the definition.

On the basis of this finding the trial judge, over the objection of petitioner, permitted evidence covering the custom and practice of securities dealers in the District of Columbia to confirm as principal when they were acting as agent. Even the witnesses, upon which the Court based its findings, testified that the proper way to confirm when the issuer had control over the broker was to use the symbol "we as brokers for some other party" have sold so many shares of stock (J. A. 118-119).

The same witnesses stated that the confirmation is supposed to contain the actual agreement with the individual purchaser (J. A. 120). The President of the respondent testified that the confirmation is our contract with the purchaser (J. A. 154).

The petitioner moved to strike the testimony of the witnesses insofar as it referred to the practices as to a "best efforts" underwriting on the ground that it was the law and the regulations of the S. E. C., and

not practice, which should govern the decision in this case, and the motion was denied (J. A. 168).

In the case of *Cudahy Packing Company* v. *Narzissenfeld*, 3 F. (2d) 567, the question of the right to submit testimony of a local usage or custom was in issue, and the Court, at page 572, said:

> "It is well settled law that usage will not be allowed to subvert an established rule of law. To allow this to be done, as was said in Barnard v. Kellogg, 10 Wall 383, 19 L'ed 987, would lead to mischievous consequences, embarrass trade, and be against public policy. An established rule of law cannot be changed by any local custom of the place where the contract is made."

In *Cobin* v. *Midland Mutual Life Insurance Company*, 260 F. (2d) 92, it is stated that proof of the customs and usages of a particular business is not admissible to oppose or alter a rule of law or to change the legal rights or liabilities of parties fixed by law.

In addition to the foregoing, there was no evidence of any kind that petitioner had any knowledge of the alleged custom of securities' dealers in the District of Columbia. The petitioner is a doctor and there is nothing in the record to indicate that he had any connection with securities' dealers.

In the case of *U. S. Shipping Board Emergency Fleet Corporation* v. *Levensaler, et al.*, 53 App. D. C. 322, 290 F. 297, the Court stated that in order to require that a person be bound by custom and usage, it must be shown that the party charged have knowledge of the custom, and the Court stated, at page 327:

> "'Knowledge of the customes sought to be proved, being peculiar to a particular business,

must be first brought home to the party sought to be charged, where, as in this case, the party to be charged was engaged in a separate and distinct line of business. Whatever may be the rule as to presumptive notice of a custom or usage in the case of parties engaged in the same business, clearly no such presumption can be indulged in where the party to be charged is engaged in a separate line of business.' "

The Judgment Affirming a Finding That Respondent Was an Agent Is in Direct Conflict With the Regulation Requiring Disclosure of Control

The petitioner contends that the confirmation disclosed that the respondent acted as principal and that the wording of the confirmation is clear and unambiguous, and that the circumstances surrounding the execution of a contract cannot be considered in construing it, where the contract is in writing and is clear and definite in its terms. *No Leak O. Piston Ring* v. *Chandler*, 53 App. D. C. 128, 299 Fed. Rep. 526.

There is nothing in the record to indicate that respondent considered itself an agent. The trial Court refused to permit petitioner to cross-examine the President of respondent corporation concerning statements made by him under oath that he was not under the direction and control of the issuer. A proffer was made of this evidence and it appears on page 163-164 of the joint appendix.

In order for the Court to find that the relationship of principal and agent existed between the issuer and the respondent, it not only had to ignore the plain wording of the confirmation of the sale but it had to find that respondent was under the direction and control of the issuer.

Section 240.15c1-5 of Title 17 of the Code of Federal Practice, supra, requires any broker or dealer who is controlled by, controlling or under common control with the issuer, to disclose to his customer the existence of such control at or before the completion of the transaction. The respondent, by its confirmation, definitely disclosed that it was acting on its own and not controlled in any way by the issuer.

The trial Court apparently made up its mind that the contract between the issuer and the respondent created the relationship of principal and agent and that anyone who purchased stock from the respondent was presumed to have knowledge of this relationship and bound thereby. The Regulations of the S. E. C. were then ignored.

The trial Court ignored every bit of evidence that disclosed in any way that no such agency existed as between the issuer and the respondent. It would not permit evidence of past testimony of the President of respondent that the issuer had no control over its actions and that respondent was under the supervision of the S. E. C. and the National Association of Securities Dealers and under no one else's authority, except the laws of the United States (J. A. 163).

The trial Court also ignored the fact that the stock had been withdrawn by the issuer and that at the time respondent sold the stock to petitioner it did not have any stock of the issuer left under the underwriting agreement to sell.

The testimony of the President of the respondent is that the confirmation, plaintiff's exhibit No. 1, (J. A. 169) was its contract with its customer and in the face

of this statement the trial Court still ignored the plain words of the confirmation that respondent sold as principal and ruled that it acted as an agent.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit should be granted.

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